McCRORY CORPORATION

1963 ANNUAL REPORT

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BOARD OF DIRECTORS

Isidore A. Becker
Patrick J. Clifford
Albert N. Greenfield
Bernard Kobrovsky
Stanley H. Kunsberg
Harold M. Lane
Harold M. Lane, Jr.
Leonard C. Lane
Seymour Lazar
Samuel J. Levy
Donald L. Miller
Samuel Neaman
John E. Nelson
Gilbert H. Perkins
Bert R. Prall
Meshulam Riklis
George Schwartz
Lorence A. Silverberg
Leonard Spangenberg
Harry H. Wachtel
J. S. Weinstein

OFFICERS

Meshulam Riklis . . . . *Chairman of Board of Directors*
Harold M. Lane . . . . *President*
Harry H. Wachtel . . . . *Vice Chairman of Board of Directors & Executive Vice President*
Leonard C. Lane . . . . *Vice Chairman of Board of Directors*

VICE PRESIDENTS

Harold M. Lane, Jr.
Executive Vice President

Isidore A. Becker
Financial Vice President & Treasurer

Samuel Neaman
Administration

Bruce A. Jacobi
Real Estate

DIVISIONAL PRESIDENTS

Stanley H. Kunsberg
Lerner Shops

John E. Nelson
McCrory-McLellan-Green Stores

Julius Sanditen
Otasco-Economy Stores

Seymour Greene . . . . *Secretary*

EXECUTIVE COMMITTEE

Leonard Spangenberg, *Chairman*

Harold M. Lane
Leonard C. Lane
Gilbert H. Perkins
Bert R. Prall
Meshulam Riklis
Harry H. Wachtel
Jacob S. Weinstein

COMMITTEE CHAIRMEN

Bernard Kobrovsky . . . . *Salary and Compensation Committee*
Lorence A. Silverberg . . . . *Stock Option Committee*
Leonard Spangenberg . . . . *Executive Committee*
Jacob S. Weinstein . . . . . *Acquisition and Diversification Committee*

AUDITORS Arthur Andersen & Co., New York, N. Y.

GENERAL COUNSEL Wachtel & Michaelson, New York, N. Y.

TAX ADVISORS Hanigsberg, Delson & Broser, New York, N. Y.

The Annual Meeting of Stockholders will be held at the Corporation's Distribution Center, 2955 East Market St., York, Pennsylvania, on Tuesday, May 26, 1964, at 2:00 p.m. local time. Each stockholder entitled to vote thereat will receive by mail a formal notice of meeting, together with proxy statement and form of proxy, on or about April 30, 1964, at which time proxies will be solicited by order of the Board of Directors.

TO OUR STOCKHOLDERS:

We are pleased to submit to you this report of operations for the fiscal year ended January 31, 1964, a year of consolidation and review, as well as a year of progress.

Sales for the year were $569,115,656, an increase of $15,263,851 (2.75%) as compared with the calendar year 1962.

Total earnings for the fiscal year aggregated $4,665,251. This is equal to 64¢ per common share, after deducting preferred and preference dividends of $1,308,000.

Three significant items which affected these earnings warrant special comment:

(1) A special credit of $817,141 (net of a small disposition loss) is included in the above earnings. It represents the elimination of excess tax reserves which had been set up for previous years.

(2) Extraordinary non-recurring expenses of $1,033,588 (net of taxes) required to make our York Distribution and Data Processing Center fully operative were charged against these earnings. Your management believes the years ahead will reap the benefit of this current charge of 20¢ per common share. Earnings per common share from this year's operations, exclusive of this extraordinary expense and of the special credit referred to above, thus reflected a 50% increase over 1962 operations.

(3) Earnings were further charged with $2,816,000 as a reserve for deferred Federal taxes, notwithstanding the fact that such taxes, based upon accelerated tax depreciation and upon filing of consolidated returns, will not be currently payable. Based upon present and projected Company programs for capital additions for new store openings and major store additions and renovations, your management believes that the liability represented by the reserve for deferred taxes will not become currently payable in the foreseeable future.

This year, as in the past, we note for special emphasis that operations during the year generated $16,000,000 of cash flow (cash earnings), or $2.80 per common share (exclusive of special credits and after Preferred and Preference dividends), an increase of $2,000,000, or 40¢ per share, over 1962. These cash earnings include depreciation and amortization totalling $10,000,000.

The soundness of your Corporation's financial position is highlighted by the following:

- A balance sheet net worth of $115,316,668, or $17.41 per common share.
- Working capital of $67,209,081, including $12,514,438 in cash.
- A 2.4-to-1 ratio of current assets to current liabilities.
- Reduction of long term debt by $8,018,593.
- The signing on October 29 last of a revolving credit agreement for $57,000,000 with four banks at the prevailing prime rate. This agreement is a major factor in expediting the improvements that we believe necessary to the short-range and long-term strength of the business.
- The disposal of certain assets on a favorable basis. The sale of 30 Yellow Front Stores and a warehouse announced November 8, 1963; the sale of Harris Standard Paint Company announced November 21; and the sale on

January 31, 1964 of the larger National Shirt Shops Division brought over $10,000,000 in cash into our treasury.

The vote in September 1963 to keep the Lerner Stores within the McCrory Corporation family of units resulted in the adoption of a program designed to bring the Lerner know-how to our M-M-G variety store division. This program is now in force.

The operations of our Otasco-Economy Stores Division have remained basically separate from our other operations, and again last year made their outstanding contribution to our earnings. Their sales and earnings have again peaked to top all previous years.

We shall continue to stress efforts to increase sales in all divisions, to reduce costs and, by these means, to improve profits.

The year 1963 witnessed a number of important management changes, of which the principal ones were:

The election of Harold M. Lane as president and chief executive officer of the Corporation in June, 1963; and

The election of John E. Nelson, the new president of the McCrory-McLellan-Green Division. Recently appointed a Director, Mr. Nelson came to us in October from the J. J. Newberry Company where he had a long and eminent career, rising from store manager to president. His intimate knowledge of every facet of the variety store business could be a major asset to McCrory.

In 1964, our York Distribution Center will be fully operational for the entire year, servicing approximately 500 M-M-G variety stores. Maximum utilization of this modern facility should significantly improve the yield of this division for the current and future years.

The prospect for continued prosperity in the nation increases our confidence that your management will produce further improvements for the corporation during the current year and for the future.

An enterprise as large as McCrory Corporation must operate with a policy and an active program gauged to produce optimum financial results in a field that is characterized by intense competition. Your management believes that we can prevail in this competition. McCrory Corporation has made substantial changes to bring its structure into line with its program of streamlining and strengthening the corporation. You can be certain that every action your management takes will be in conformity with this plan.

Harold M. Lane

HAROLD M. LANE
President

M. Riklis

MESHULAM RIKLIS
Chairman of the Board

The Company mourns the death of two of its principal officers—Graham Magee and Herbert D. Silver. To the families, and to the many close friends, of Mr. Magee and Mr. Silver, we extend our heartfelt condolences. Their loss has been most keenly felt. Their skills and great personal charm will be missed.

McCRORY-McLELLAN-GREEN STORES DIVISION

JOHN E. NELSON	*President*
HAROLD M. LANE, JR.	*Executive Vice President*
L. C. SHOCKLEY	*Senior Vice President*
GEORGE A. RICHNER	*Vice President*
W. GLENN JAMESON	*Vice President*
MILES ELLIS	*Vice President*
J. F. KING	*Vice President*
BRUCE A. JACOBI	*Vice President*
DAVID D. GREENWALD	*Vice President*
R. O. KRISTIANSEN	*Vice President*
BERNARD ORINGER	*Vice President*

OFFICE: 31-39 WEST 34TH STREET, NEW YORK, N. Y.
WAREHOUSES: YORK, PA. — OKLAHOMA CITY, OKLA.

CASSELS UNITED STORES

PAUL SWAYNGHAM . . . . . *Vice President & Operating Manager*

OFFICE AND WAREHOUSE: EASLEY, S. C.

At the close of the last fiscal year, our variety stores division had in operation 589 McCrory, McLellan or Green Stores, plus 70 stores in its Mobile and Cassels Divisions. During the year, fourteen new stores were opened, ten were substantially improved and a number of others were partially refurbished. Twenty older stores were closed as a part of our continuing program of upgrading and improving our operations.

For the current year, we expect to continue our established policy of opening new stores and of improving our existing stores.

Christmas in Melbourne, Florida, has something in common with Christmas in Michigan — but it has flowers, too.

Opening day at Casselbury, Florida. Looking for sneakers? sweaters? slips? We've got 'em for these satisfied customers.

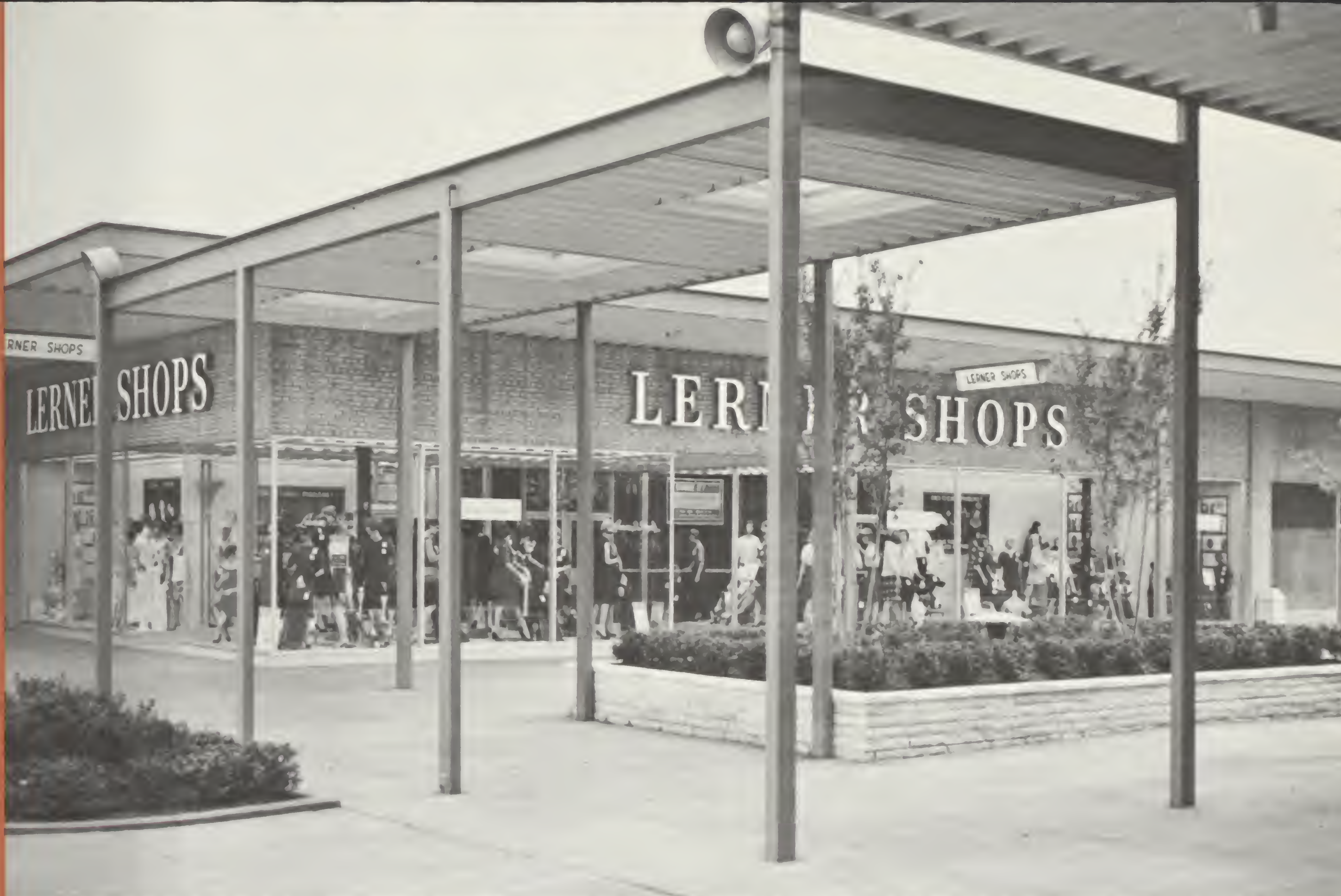
Bobby pins? Sure! And lots more, too, at our new Madison, Tennessee, store.

LERNER SHOPS DIVISION

Harold M. Lane	*Chairman of Board of Directors*
Stanley H. Kunsberg	*President*
Harold M. Lane, Jr.	*Executive Vice President*
Harold F. Miller	*Senior Vice President & Secretary*
D. John Palladino	*Vice President & Treasurer*
Benjamin J. Timoner	*Vice President*
Milton Seegal	*Vice President*
Robert L. Krill	*Vice President*
Harold Greene	*Vice President*
Eugene Shaw	*Vice President*
Melvin J. Redmond	*Vice President*
Karl Margolies	*Vice President*
Nathan B. Epstein	*Vice President*
Samuel S. Brand	*Vice President*
David D. Greenwald	*Vice President*
Bruce A. Jacobi	*Vice President*
Eugene D. Frank	*Vice President*
Jacob J. Scher	*Vice President*

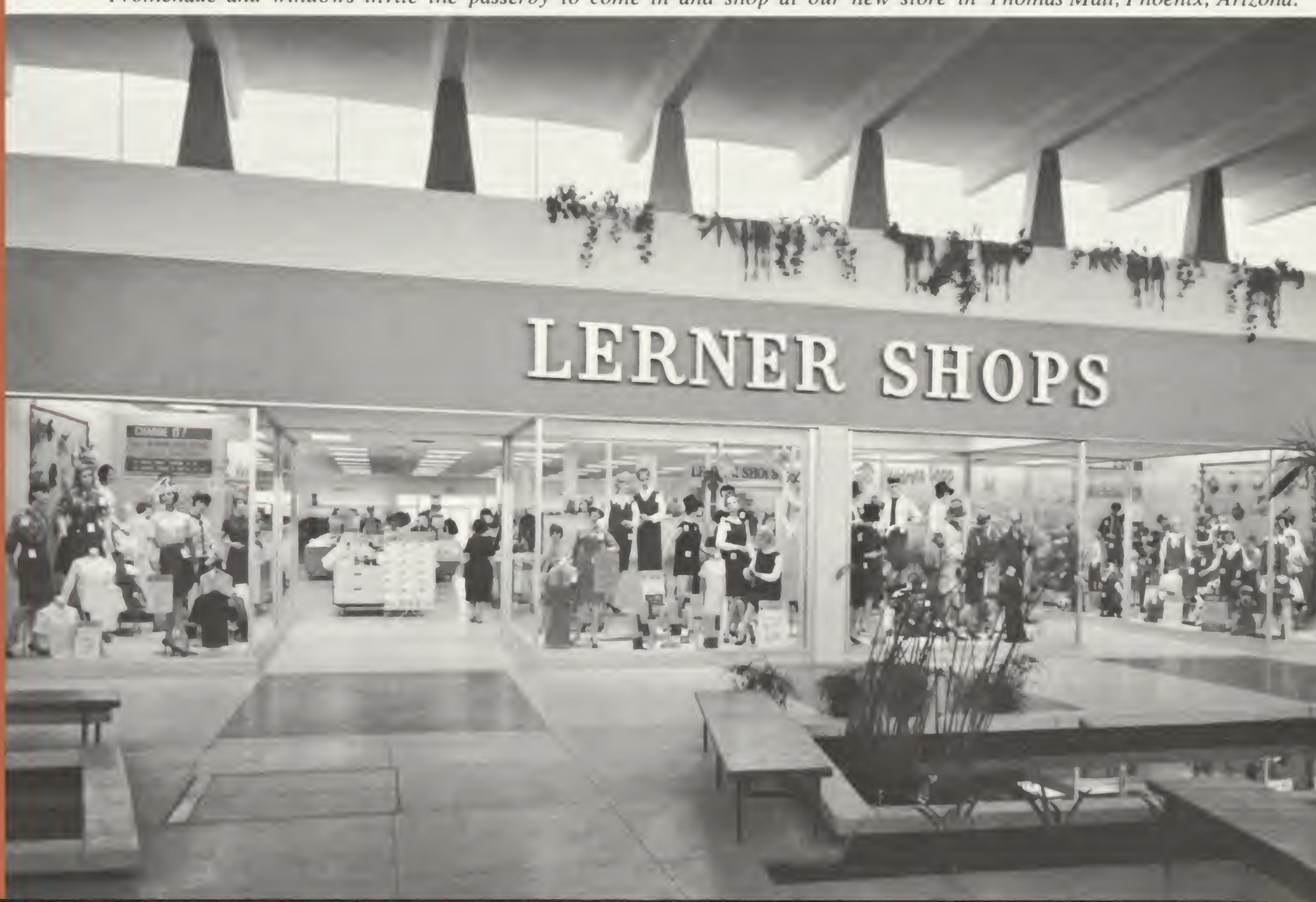
For the year ended January 31, 1964 this Division's sales again rose to achieve the highest volume in Lerner's forty-five years of operations. Earnings too topped last year's and were the highest since 1948. During the year, ten stores had major improvements, a number of others were renovated or partially refixtured, and three old stores were closed. We opened twelve new stores during the year, and there are now 329 Lerner Shops in operation as well as the three Lanes Stores. The latter are department stores operating on a high volume, low mark-up basis.

We plan to open eleven new Lerner Shops during the current fiscal year. Four are planned for rapidly expanding suburban areas in California, to bring our total there to 45. Two are planned for Puerto Rico, where two new stores were also opened last year, which will bring the total to eight Lerner Shops, to serve its fast-growing economy and tourist trade.



Chic "government girls" and fashion conscious budget minded wives are made welcome at our new store in Capital Plaza, just outside Washington in Hyattsville, Maryland.

Promenade and windows invite the passerby to come in and shop at our new store in Thomas Mall, Phoenix, Arizona.



OTASCO-ECONOMY STORES DIVISION

Maurice Sanditen	*Chairman*
Julius Sanditen	*President*
Ely G. Sanditen	*Senior Vice President*
Abe Brand	*Vice President*
Samuel H. Minsky	*Secretary*
Herman Sanditen	*Treasurer*

Office: 6901 East Pine Street, Tulsa, Okla.
Warehouses: Tulsa, Okla. – Little Rock, Ark. – Atlanta, Ga.

Record sales and earnings were achieved for last year by our home and auto supply stores division which at the year end had in operation 133 Company stores and 269 Associate stores. During the year, we opened 8 new Company and 23 new Associate stores; four old Company and two Associate stores were closed. Twelve of our Company stores were substantially improved during the year, and eight were partially refurbished or refixtured. A number of our Associate dealers remodeled their stores, as well.

During the current year, we plan to open eight new Company stores and 20 new Associate stores in our Southeastern and Southwestern areas. A new 147,000 square foot warehouse in the Atlanta area will shortly replace an inadequate facility, for greater economy and efficiency.

Almost anything for the car or home—inside and outside—is offered at new Economy Auto Store, Gadsden, Alabama.

Our new shopping center store in Moore, Oklahoma, offers one-stop convenience.

Newly remodeled Wellington, Kansas, store on the eve of re-opening.

CONSOLIDATED BALANCE SHEET JANUARY 31, 1964

ASSETS

CURRENT ASSETS:		
Cash		$ 12,514,438
Accounts receivable (less reserves of $1,377,580)—		
Customers' accounts	$ 2,864,740	
Equity in installment accounts sold (the uncollected balances of which amount to $23,240,448)	1,498,863	
Other	1,910,892	6,274,495
Merchandise inventories (Note 9)		92,514,040
Prepaid insurance, taxes, rents, store supplies, etc.		2,242,842
Notes and mortgages receivable		1,626,849
TOTAL CURRENT ASSETS		$115,172,664
PROPERTY AND EQUIPMENT, at cost:		
Store properties and warehouses	$ 16,065,391	
Furniture and fixtures and improvements to leased property	140,570,056	
	$156,635,447	
Less—Accumulated depreciation and amortization	77,814,619	78,820,828
OTHER ASSETS:		
Excess of purchase cost of 1,263,617 shares (99% ownership) of Lerner Stores Corporation common stock over underlying net equity at dates of acquisition (Note 8)	$ 17,075,188	
Debenture discount, less amortization of $2,459,238	8,397,704	
Investment in and advances to subsidiary not consolidated (Notes 1 and 14)	5,564,406	
Goodwill, less amortization of $276,811	1,075,817	
Mortgages and sundry receivables	1,488,067	
Deferred charges (Note 6)	2,275,691	35,876,873
		$229,870,365

The accompanying notes to consolidated financial

LIABILITIES AND SHAREHOLDERS' INVESTMENT

CURRENT LIABILITIES:		
Current maturities of long-term debt (Note 7)		$ 6,306,905
Accounts payable		28,239,014
Accrued expenses and sundry liabilities		13,417,664
TOTAL CURRENT LIABILITIES		$ 47,963,583
LONG-TERM DEBT, less current maturities (Note 7)		54,854,092
DEFERRED ITEMS:		
Deferred Federal income taxes (Note 5)	$ 8,814,762	
Other	1,102,281	9,917,043
MINORITY INTEREST—in preferred ($1,356,000) and common stock of Lerner Stores Corporation		1,818,979
SHAREHOLDERS' INVESTMENT (Notes 10 and 11):		
Preferred stock, cumulative, $100 par value, series issue, authorized 34,791 shares—		
3½% series cumulative convertible, authorized and outstanding 14,791 shares	$ 1,479,100	
$6.00 cumulative convertible preference stock, $100 par value—authorized 95,695 shares, outstanding 94,725 shares	9,472,500	
Preference B stock, $100 par value, series issue, authorized 187,906 shares—		
5½% series, cumulative (subordinated and convertible), authorized and outstanding 11,871 shares	1,187,100	
4½% series, cumulative (subordinated and convertible), authorized 130,079 shares, outstanding 124,641 shares	12,464,100	
Common stock, $.50 par value—authorized 15,000,000 shares, issued 5,977,367 shares	2,988,683	
Capital surplus (Note 10)	39,094,164	
Earned surplus (Note 10)	63,524,752	
	$130,210,399	
Less—766,971 common shares of treasury stock, at cost	14,893,731	115,316,668
		$229,870,365

statements are an integral part of the above balance sheet.

STATEMENT OF CONSOLIDATED NET INCOME

FOR THE YEAR ENDED JANUARY 31, 1964

NET SALES—Merchandise, restaurant and concession		$569,115,656
Cost of goods sold, buying and occupancy expenses, net of service charge income	$411,220,653	
General and administrative expenses	135,411,957	546,632,610
OPERATING PROFIT BEFORE DEPRECIATION AND AMORTIZATION		$ 22,483,046
Provision for depreciation and amortization		9,370,285
OPERATING PROFIT		$ 13,112,761
OTHER EXPENSES (Net):		
Interest	$ 6,631,828	
Debenture discount	866,864	
	$ 7,498,692	
Less—Investment income, earnings of subsidiary not consolidated (Note 1), and miscellaneous income (net)	2,134,775	5,363,917
PROFIT BEFORE PROVISION FOR INCOME TAXES AND EXTRAORDINARY EXPENSES		$ 7,748,844
PROVISION FOR DEFERRED FEDERAL INCOME TAXES		2,816,000
PROFIT BEFORE EXTRAORDINARY EXPENSES		$ 4,932,844
EXTRAORDINARY EXPENSES of York Distribution and Data Processing Center, net of Federal tax benefit (Note 3)		1,033,588
NET INCOME BEFORE ELIMINATION OF MINORITY STOCKHOLDERS' EQUITY IN EARNINGS OF LERNER STORES CORPORATION		$ 3,899,256
Minority Stockholders' Equity in Earnings of Lerner Stores Corporation		51,146
NET INCOME APPLICABLE TO SHAREHOLDERS OF McCRORY CORPORATION		$ 3,848,110
SPECIAL CREDIT—NET (Note 5)		817,141
NET INCOME AND SPECIAL CREDIT		$ 4,665,251

The accompanying notes to consolidated financial statements are an integral part of the above statement.

STATEMENTS OF CONSOLIDATED SURPLUS

FOR THE YEAR ENDED JANUARY 31, 1964 (NOTE 2)

	EARNED SURPLUS	CAPITAL SURPLUS
BALANCE, January 31, 1963 (Note 2)	$64,647,555	$39,097,680
ADD (DEDUCT):		
Net income and special credit	4,665,251	—
	$69,312,806	$39,097,680
Dividends paid during year:		
Common stock ($.80 per share)	($ 4,181,440)	$ —
3½% series, cumulative convertible preferred stock ($3.50 per share)	(51,770)	—
$6 cumulative convertible preference stock ($6.00 per share)	(568,575)	—
5½% series, cumulative (subordinated and convertible) preference B stock ($5.50 per share)	(64,644)	—
4½% series, cumulative (subordinated and convertible) preference B stock ($4.50 per share)	(561,995)	—
Dividends on preferred stock of Lerner Stores Corporation	(60,561)	—
	($ 5,488,985)	$ —
Excess of cost of 13,567 shares of treasury stock issued under option plans over option price (Note 11)	($ 111,609)	$ —
Reduction of McCrory's equity in Lerner Stores Corporation resulting from Lerner reacquisitions of its common stock	(190,046)	—
Other—net	2,586	(3,516)
BALANCE, January 31, 1964	$63,524,752	$39,094,164

The accompanying notes to consolidated financial statements are an integral part of the above statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JANUARY 31, 1964

(1) Principles of consolidation:

The accompanying consolidated financial statements as of January 31, 1964, reflect the consolidation of the accounts of Lerner Stores Corporation (whose common stock is 99% owned) and all wholly-owned subsidiaries except McCrory Credit Corporation. The investment in the credit subsidiary not consolidated is stated in the consolidated balance sheet at the amount of the Company's equity in the capital and undistributed earnings ($553,440) of such subsidiary at January 31, 1964. Net income ($321,050) of the nonconsolidated credit subsidiary for the year ended January 31, 1964, is included in the McCrory consolidated net income for that period. (See Note 14 for additional information on McCrory Credit Corporation.)

(2) Change in Fiscal Year:

Since the last annual report to stockholders, the Company has, with the consent of the Internal Revenue Service, changed its fiscal year from December 31 to January 31; accordingly, the accompanying financial statements relate to the fiscal year ended January 31, 1964, rather than the calendar year 1963. The operating results for the month of January, 1963, which were separately shown in the proxy statement dated September 5, 1963, relative to the special meeting of stockholders held on September 30, 1963, have not been included herein. The following is an analysis of Earned Surplus and Capital Surplus from December 31, 1962 (date of financial statements included in the previous annual report to stockholders), to January 31, 1963:

	Earned Surplus	Capital Surplus
Balance, December 31, 1962	$67,869,039	$39,310,675
Net loss for the month of January 1963	(3,078,369)	—
Excess of cost of 15,544 shares of treasury stock issued under stock option plans over option price	(143,115)	—
Excess of cost of Lerner Stores Corporation common stock reacquired by Lerner over stated value thereof	—	(217,345)
Other	—	4,350
Balance, January 31, 1963	$64,647,555	$39,097,680

(3) Extraordinary Expenses:

During 1963, the Company opened a 750,000 square foot distribution and data processing center in York, Pennsylvania and began a program to close certain less efficient warehouses, as the York Distribution Center increased its level of operations. Since the Center's operations are still undergoing revision and have not yet reached designed or planned levels of throughput, applicable expenses exceeded the normal amounts charged to store operations by $1,033,588, net of Federal tax benefit. This amount has been shown as an extraordinary expense in the accompanying statement of consolidated net income.

(4) Sale of Divisions:

The Company sold the business and net operating assets of the National Shirt Shops Division as of January 31, 1964, for book value, approximately $5,000,000. Accordingly, the accompanying consolidated balance sheet does not include these net operating assets, although the sales, costs and expenses of the Division have been included in the accompanying statement of consolidated net income for the year ended January 31, 1964.

During 1963, the Company acquired the net assets and business of Harris Standard Paint Company and subsequently disposed of same. Both transactions were based on book values, and accordingly, the increase in the equity of Harris during the period of ownership, less the expenses involved in the sales, is reflected in investment income on the accompanying statement of consolidated net income.

(5) Special Credit—Net:

The items included in the Special Credit in the accompanying consolidated financial statements for the year ended January 31, 1964, are as follows:

Reversal of prior year provisions for deferred Federal income taxes	$1,000,000
Loss on sale of the Yellow Front Stores, net of Federal income tax benefit	(111,957)
Expenses in connection with the proposed sale of Lerner Stores Corporation not consummated, net of Federal income tax benefit	(70,902)
Special Credit—Net	$ 817,141

In the opinion of the Company and of Hanigsberg, Delson and Broser, tax advisors to the Company, the reserves for deferred Federal income taxes exceeded the required amounts by $1,000,000; accordingly, this amount has been reflected as a Special Credit in the accompanying financial statements.

The Internal Revenue Service has not reviewed the Company's Federal income tax returns for years subsequent to 1958, although it does have under review the tax returns of Lerner Stores Corporation and subsidiaries for the fiscal years ending in 1958, 1959 and 1960, and has proposed additional assessments for these years. The Lerner management believes that there is no merit to the proposed adjustments for all the years involved and that the ultimate disposition thereof would have no material effect on the Lerner financial statements (not presented separately herein); accordingly, no provision for additional Federal income taxes has been made for such items for years subsequent to 1958.

(6) Deferred Charges:

Deferred charges include $528,000, net of Federal income tax benefit, representing costs of development and preoperating expenses of the York Distribution Center and costs incurred in closing old warehouses. The Company has recognized these costs as York Distribution Center start-up and training costs which should be charged against revenues derived in future operations and will amortize the deferred amount over a five-year period beginning in 1964.

(7) Long-Term Debt:

Long-term debt at January 31, 1964, including maturities due within one year, consisted of the following:

	Total	Current Maturities	Long-Term Debt
5½% sinking fund subordinated debentures, due 1976 (a)	$36,040,960	$ —	$36,040,960
5.235% subordinated notes due in equal annual installments to 1971	14,290,276	1,786,285	12,503,991
3% sinking fund debentures due in 1967 (b)	4,277,000	477,000	3,800,000
Notes payable to bank — paid February 1, 1964	3,500,000	3,500,000	—
Mortgages payable	2,480,761	372,620	2,108,141
4% notes due in equal annual installments to 1967	265,000	67,000	198,000
3¾% notes due in annual installments to 1966	307,000	104,000	203,000
	$61,160,997	$6,306,905	$54,854,092

(a) Exclusive of $6,233,000 redeemed ($1,305,000 cancelled and $4,928,000 held in treasury, available for sinking fund requirements). Sinking fund requirements in each year (which may be satisfied, through 1967, with the aforesaid debentures held in treasury) are as follows: 1965 and 1966—$1,024,224; 1967 through 1971—$2,048,448; 1972 through 1976—$3,277,517, with a final payment of $12,290,687 due on August 14, 1976.

(b) Exclusive of $123,000 in treasury. Sinking fund requirements are $600,000 in each year to 1966 and $2,600,000 at maturity.

The restrictive covenants of (a) the indentures covering the 5½% sinking fund subordinated debentures and the 5.235% subordinated notes payable, and (b) a $57,000,000 revolving credit agreement with several banks (under which there was no outstanding indebtedness at January 31, 1964) provide, among other matters, for the maintenance of specified amounts of working capital, as defined, and for certain limitations on indebtedness, as defined, which requirements at January 31, 1964, were met as follows:

(i) Consolidated working capital (as defined) which amounted to $67,209,081 must be maintained at least equal to $55,000,000.

(ii) Consolidated current assets were 245% of consolidated current liabilities (as defined) as compared to the 175% requirement.

(iii) Consolidated indebtedness (as defined) of $42,350,000 which should not be in excess of 50% of consolidated net worth, was $15,308,234 less than the maximum indebtedness allowed.

(8) Excess purchase cost of Lerner Stores Corporation common stock:

During 1961 and 1962, McCrory acquired 1,263,617 shares (99% ownership as of January 31, 1964) of Lerner Stores Corporation common stock principally as the result of a tender offer made on August 10, 1961. The aggregate cost of the investment in Lerner exceeded the McCrory equity in underlying Lerner net assets at dates of acquisition by $17,075,188. This excess purchase cost has been recognized by the McCrory management to be similar in nature to intangibles which have not declined in value since date of acquisition. Accordingly, the McCrory management has adopted an accounting policy of not amortizing this excess purchase cost, so long as there is no recognized diminution in value of its investment in Lerner.

(9) Merchandise inventories:

Merchandise inventories, stated at the lower of cost or market, consists of the following:

Raw materials, including merchandise at contractors — at specific invoice cost or replacement cost		$ 528,119
Merchandise in transit, at warehouses, and at restaurants—at cost		18,054,491
Merchandise in stores—		
at retail method	$66,869,235	
at first-in, first-out cost	7,062,195	73,931,430
		$92,514,040

(10) Preferred and preference stock and warrants:

At January 31, 1964, there were 522,915 shares of common stock reserved for the conversion of preferred and preference stock, as follows:

Class of Stock	Redemption Price	January 31, 1964 Conversion Rate Common Shares For Preferred or Preference	Shares of Common Stock Reserved
3½% cumulative convertible preferred . .	$104	5 for 1	73,955
$6 cumulative convertible preference . . .	115	3/14 for 1	20,298
5½% cumulative preference B	100	6-1/9 for 1	72,545
4½% cumulative preference B	100	2-6/7 for 1	356,117
			522,915

In addition, 2,673,467 shares of common stock were reserved for the exercise, at $20 per share, of warrants (expiring in 1976) issued in connection with the 1961 merger of H. L. Green and the 1961 purchase of Lerner stock.

Pursuant to certain restrictions in connection with the authorization of preferred stock, capital and earned surplus at January 31, 1964, in the approximate amount of $17,000,000 (including $15,417,719 restricted as the result of purchase of McCrory preference and common stock) are restricted as to future payments of dividends on the common stock or purchase or redemption of shares of its stock.

(11) Stock Option and Employee Stock Purchase Plans:

Under the Company's restricted stock option plans adopted during 1960 and 1961, options for 791,960 shares of common stock were outstanding at January 31, 1964 at prices ranging from $11.88 to $22.80 per share (95% of fair market value on dates of grant), of which 369,080 shares were exercisable at that date. There remain available 234,620 shares for future option grants under these Plans. Options to purchase 2,740 shares were exercised during the year at an aggregate option price of $34,986. There were no options granted during the year ended January 31, 1964 under these Plans.

Options granted are exercisable for a maximum of ten years. Options generally become exercisable to the extent of 20% each year on and after the anniversary dates of the grants with respect to the 1960 Plans, and 20% each year on and after the second anniversary dates of the grants with respect to the 1961 Plan. Options may not be sold, transferred, assigned, pledged or disposed of by the optionee except by will or laws of inheritance. In the event of termination of employment by resignation, disability or death, all options will expire within varying periods up to the full term of such options.

In addition to the foregoing restricted stock option plans, the Company on January 31, 1964 granted to a key employee an option to purchase 15,000 shares of its common stock held in the treasury; the option price of $13.50 per share was 95% of the fair market value on the date of grant.

Employee stock purchase plans adopted during 1960 and 1961 permit the grant of rights to purchase a total of 190,000 shares of common stock at 85% of the fair market value thereof on the dates of grant. Rights to purchase 10,827 shares were exercised during the year at an aggregate purchase price of $119,638, and at January 31, 1964, 35,645 shares were under subscription at prices ranging from $10.63 to $14.24. At January 31, 1964, rights for 115,671 shares were available for subscription.

(12) Pension Plans:

Under the Company's noncontributory retirement plan covering eligible employees of the McCrory-McLellan-Green Division, the cost of the plan will be met, as required, by periodic contributions to the trust fund. The amounts accumulated in the trust fund in respect of the McCrory-McLellan-Green plan, exceed the actuarial liability as computed by the consulting actuary. For this reason, no provision for costs under this plan was reflected in the statements of consolidated net income subsequent to 1960. Contributions of $400,000, net of Federal income tax benefit, required under the terms of other noncontributory retirement plans and profit sharing plans for employees of Oklahoma Tire and Supply and National Shirt Shops Divisions, and Lerner Stores Corporation, paid or accrued during the year, have been reflected in the accompanying statement of consolidated net income.

(13) Lease Commitments:

At January 31, 1964, the minimum annual rentals upon property leased to the Company and its subsidiaries under leases expiring after January, 1967, amount to approximately $22,000,000, plus, in certain instances, real estate taxes, insurance, etc. The Company remains contingently liable under certain long-term leases assumed by the respective purchasers in connection with several sales of store operations, particularly with respect to those of Butler Brothers and Metropolitan Stores, sold in prior years. However, the Company has receiyed from the purchasers valid and enforceable agreements of assumption of liabilities and indemnification in form satisfactory to counsel for the Company.

(14) McCrory Credit Corporation:

McCrory Credit Corporation, a wholly-owned subsidiary of McCrory Corporation, was organized to (a) purchase retail installment sales paper from McCrory and subsidiaries and affiliates, and (b) through a separate leasing subsidiary, to acquire equipment for lease to the McCrory-McLellan-Green Division of McCrory Corporation under a 15-year lease agreement.

At January 31, 1964 the credit corporation and its subsidiaries had invested $23,700,000 in customers' deferred payment accounts of McCrory and subsidiaries and affiliates and an additional $1,500,000 in equipment purchased for rental. Financing of the foregoing had been provided principally from (1) $1,000,000 of equity funds and $4,000,000 in subordinated loans from McCrory Corporation and subsidiaries, (2) $18,750,000 in 4½% bank loans on unsecured notes of the credit corporation, and (3) a 5½% chattel mortgage for $1,500,000.

ARTHUR ANDERSEN & CO.

80 PINE STREET
NEW YORK, N. Y. 10005

To the Shareholders of

McCrory Corporation:

We have examined the consolidated balance sheet of McCrory Corporation (a Delaware corporation) and subsidiary companies as of January 31, 1964, and the related statements of consolidated net income and consolidated surplus for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records of the Company and its wholly-owned subsidiaries and such other auditing procedures as we considered necessary in the circumstances. The financial statements of Lerner Stores Corporation, whose net assets represent approximately 33% of the total net assets included in the consolidated financial statements, were not examined by us, but we were furnished with reports of other public accountants thereon.

In our opinion, based upon our examination and upon the reports of other public accountants referred to above, the accompanying consolidated balance sheet and the related statements of consolidated net income and consolidated surplus present fairly the financial position of McCrory Corporation and subsidiary companies as of January 31, 1964, and the results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Arthur Andersen & Co.

New York, N. Y.,
April 10, 1964.

TRANSFER AGENTS	Common Stock 5½% Preference B Stock 4½% Preference B Stock	Chemical Bank New York Trust Company and First National Bank of Chicago
	3½% Preferred Stock $6 Preference Stock	Morgan Guaranty Trust Co. of New York and First National Bank of Chicago
REGISTRARS	Common Stock 5½% Preference B Stock	Morgan Guaranty Trust Co. of New York and Continental Illinois National Bank and Trust Co. of Chicago
	4½% Preference B Stock	The Chase Manhattan Bank and Continental Illinois National Bank and Trust Co. of Chicago
	3½% Preferred Stock $6 Preference Stock	Chemical Bank New York Trust Company and Continental Illinois National Bank and Trust Co. of Chicago
EXECUTIVE OFFICES	711 FIFTH AVENUE, NEW YORK, N. Y. 10022	

McCRORY CORPORATION
711 FIFTH AVENUE
NEW YORK 22, N.Y.